CLIFFORD CHANCE

Client Briefing
June 2011

# Structuring Chinese investments through the Netherlands

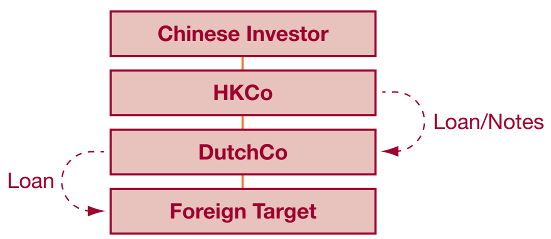
## Introduction

This client briefing provides a high-level overview of the advantages of structuring Chinese investments through the Netherlands.

The Netherlands is considered one of the best holding jurisdictions in view of its tax system, including a full exemption on income and capital gains derived from subsidiaries, its extensive tax treaty and investment treaty network, its flexible corporate laws and high quality of corporate service providers.

## Summary of Dutch holding structure

A typical international holding structure, where a Chinese investor (the "**Chinese Investor**") would invest through an intermediate Hong Kong holding company ("**HKCo**"), which in turn would invest through a Dutch entity ("**DutchCo**") in the underlying foreign target (the "**Foreign Target**"), can be depicted as follows:




## Benefits in the source state

The main benefits of the structure in the relevant foreign source state are as follows:

- The Netherlands has concluded many bilateral investment treaties, which grant DutchCo a number of guarantees for its investment in Foreign Target in the relevant source state. These guarantees typically include fair and equitable treatment and protection from expropriation. Bilateral investment treaties also normally allow for an alternative dispute resolution mechanism, giving DutchCo recourse to international arbitration.

- The Netherlands has also concluded favourable tax treaties, which typically provide for taxation reductions and exemptions in the relevant foreign source state. Examples include reduced local withholding tax rates on dividends and interest paid by the Foreign Target to DutchCo and relief from local taxation on any future capital gain realised by DutchCo from its shareholding in the Foreign Target.

- The interest on the loan granted by DutchCo to the Foreign Target may be deductible for local corporate tax purposes, effectively reducing the local corporate tax burden.

**Contents**



If you would like to know more about the subjects covered in this publication or our services, please contact:

**Wei Cui, Beijing**
**+86 10 6535 2288**
**wei.cui@cliffordchance.com**

**Kenneth Leung, Hong Kong**
**+852 2826 3565**
**kenneth.leung@cliffordchance.com**

**Joep Bertrams, Amsterdam**
**+31 20 711 9186**
**joep.bertrams@cliffordchance.com**

**Michiel Sunderman, Amsterdam**
**+31 20 711 9658**
**michiel.sunderman@cliffordchance.com**

**Frank de Vos, Amsterdam**
**+31 20 711 9110**
**frank.devos@cliffordchance.com**

Clifford Chance LLP, Droogbak 1A,
1013 GE Amsterdam, The Netherlands

www.cliffordchance.com

## Benefits in the PRC & Hong Kong

For the People's Republic of China ("**PRC**") and Hong Kong the main benefits of the structure are as follows:

- Where the Chinese Investor provides a loan to DutchCo directly, a 5% business tax (and potential surcharges) may arise in the PRC in respect of interest payable on the loan (the "5% Business Tax").
- Having HKCo provide the loan to DutchCo should mitigate the 5% Business Tax in the PRC.
- The interest payable to HKCo should not be subject to Hong Kong taxation if the loan is provided to the DutchCo outside Hong Kong (i.e. the interest has a non-Hong Kong source).[1]
- HKCo should not be subject to Hong Kong taxation in respect of the dividends received from DutchCo or in respect of any capital gains realised in respect of the DutchCo shares.
- Any income or gain realized by HKCo may be retained by HKCo without being deemed to be distributed to the Chinese Investor, as long as the retention is based on reasonable operational needs.

## Benefits in the Netherlands

The main Dutch tax benefits of the structure are as follows:

- Dividend income and capital gains derived by DutchCo from its shareholding in the Foreign Target are exempt from Dutch corporate income tax if the conditions for the participation exemption are met. See below for more information on the participation exemption.
- Interest income derived from the debt granted by DutchCo to the Foreign Target can be offset by corresponding interest deductions in the case of back-to-back lending.[2] The Netherlands does not levy withholding tax on interest.
- Any dividends and capital gains derived by the Chinese Investor or HKCo from its shareholding in DutchCo should not attract any Dutch taxation. This can be achieved by structuring DutchCo as a Dutch *coöperatie* ("**Coop**"). In this way, the Chinese Investor and HKCo should also benefit from a full exemption of Dutch taxation on such dividends and capital gains, provided that it meets the so-called "business asset test". See below for more information on the Coop and the business asset test.
- If the business asset test is not met, it would still be possible to avoid Dutch tax leakage, e.g. on the basis of the new Hong Kong – Netherlands tax treaty (when it comes into force) or through further structural enhancements.

## Participation exemption

In brief, DutchCo is entitled to the participation exemption on dividend income and capital gains derived from the Foreign Target if DutchCo owns at least 5% of the Foreign Target and the Foreign Target meets one of the following tests:

- The Foreign Target is not held as a passive investment. This test is typically met if (i) DutchCo is active in the management, finance and/or policy making of the Foreign Target or (ii) the Foreign Target and the Chinese Investor or HKCo are active companies and their activities are interrelated; or
- The Foreign Target is subject to a corporate tax regime comparable to the Dutch corporate tax regime which has a statutory tax rate on profits of at least 10%; or
- Less than 50% of the (direct and indirect) assets of the Foreign Target comprise passive assets. Real estate and assets that are used in an active business of the Foreign Target would generally not be considered as passive assets. Accordingly, active operating companies and real property investment companies would normally meet this test.

## Use of Dutch Coop

A Coop is established by the execution of a Dutch notarial deed by at least two members.[3] Therefore, it is an ideal company to use in case of joint venture situations as well as in group structures. A Coop has legal personality, can distribute profits to its members and its members can have limited liability.

A Coop is treated similarly to a "regular" Dutch limited liability company (a *Besloten Vennootschap* or *Naamloze Vennootschap*) for Dutch tax purposes with one important exception: profit distributions by a Coop to its members are not subject to Dutch dividend withholding tax. Accordingly, the Chinese Investor or HKCo should not be subject to Dutch tax on any dividend income and capital gains derived from its membership interest in, or interest paid by, the Coop, provided that the Chinese Investor or HKCo meets the business asset test.

[1] *In circumstances where the interest is treated as Hong Kong sourced and is subject to Hong Kong taxation (at a rate of 16.5%), the Chinese Investor should, however, be able to credit Hong Kong taxes against its PRC corporate income tax liability on the dividends the Chinese Investor receives from the HKCo pursuant to the PRC – Hong Kong taxation arrangement, in which case the Hong Kong tax charge on interest should not be an extra cost to the structure.*
[2] *Based on the "at arm's length principle", DutchCo should realise a small spread on the interest income paid and received.*
[3] *A second member can be a sister company of the Coop that is specifically incorporated for this role.*

## Business asset test

In order to meet the business asset test, (i) the Chinese Investor or HKCo must be considered to be engaged in an enterprise based on Dutch tax principles, and (ii) its membership right in the Coop must be allocable to that enterprise. Typical circumstances in which the business asset test would be met, include the following:

- The Chinese Investor or HKCo itself or through its investment advisor, has a team of professional asset managers with specific expertise of the industry in which the Chinese Investor or HKCo invests;

- The percentage shareholding in the Foreign Target is meaningful, e.g. majority interests or minority interest with specific control rights; and

- The Chinese Investor or HKCo is actually involved in the business of the Foreign Target, e.g. through representation at the board of directors of the Foreign Target.

## Advance confirmation

Advance confirmation (a ruling) from the Dutch tax authorities can generally be obtained with respect to the application of the participation exemption and, if relevant, the business asset test. A ruling would usually take six to ten weeks. ■